Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	
Access Charge Reform	CC Docket No. 96-262
Price Cap Performance Review for Local Exchange Carriers	CC Docket No. 94-1

VERIZON[1] COST SUBMISSION

Verizon hereby submits the cost information required by the Commission's September 17, 2001 Public Notice.[2]

In the Public Notice, the Commission formally sought the information that the incumbent local exchange carrier sponsors of the "CALLS" plan had previously agreed to submit.[3] In response, Verizon is providing three sets of data to assist the Commission in evaluating the increase in the subscriber line charge ("SLC") cap.[4] First, Verizon is providing its current

[1] The Verizon telephone companies ("Verizon") are the affiliated local telephone companies of Verizon Communications Corp. These companies are listed in Attachment A.

[2] ***See*** Public Notice, DA 01- 2163 (rel. Sept. 17, 2001).

[3] ***See*** Memorandum in support of the Revised Plan of the Coalition for Affordable Local and Long Distance Service (CALLS), at 8, attached to letter from John J. Nakahata, Counsel to CALLS, to Magalie Roman Salas, Secretary, FCC, March 8, 2000 (Modified CALLS Proposal).

[4] Verizon is providing cost information only at a study area or a tariff entity level, because Verizon has not deaveraged its SLCs and does not intend to do so on July 1, 2002. For example, the cost information for the Verizon north study areas (New York, Maine, Massachusetts, New Hampshire, Rhode Island and Vermont) is provided on a regional basis because these states have region-wide SLCs. Under the CALLS rules, carriers are permitted, but not required, to deaverage SLCs. ***See*** *Access Charge Reform*, 15 FCC Rcd 12962, ¶ 73 (2000) ("*CALLS Order*"); ***see also*** 47 C.F.R. Section 61.45(b)(ii).

carrier common line, marketing, and transport interconnection charge revenue ("Price Cap CMT") per line, which is used as a cap on the SLC under the CALLS rules (47 C.F.R. Section 69.152). ***See*** Attachment B. Second, Verizon is providing its current "base factor portion" common line costs, using the costing methodology previously applied when maximum SLC limits were based on regulatory accounting costs. ***See*** Attachment C. Third, Verizon is providing forward-looking studies of the costs of providing retail residential and single line business voice grade access to the public switched telephone network. ***See*** Attachment D.

In the *CALLS Order*, the Commission adopted the average Price Cap CMT per-line as part of the capping mechanism for SLCs in section 69.152 in order to create a more economic rate structure that would produce important consumer benefits and promote competition.[5] The Commission found that elimination of PICCs and carrier common line charges on interexchange carriers through increases in SLCs would provide an incentive for the local exchange carriers to avoid costs and reduce prices as they face increased competition from competing local exchange carriers. ***See*** id., ¶ 89. The Commission also found that this rate structure would be more apparent to the end user than PICCs and carrier common line charges, which are hidden within interexchange carrier charges, and it would avoid inducing interexchange carriers to avoid presubscription for low volume customers. ***See*** id. In addition, the Commission found that elimination of the multi-line PICC charges through increases in the SLC caps for primary residence and single-line business lines removes the distortions in the current rate structure that induce competitors to target their investment towards urban business customers because of the

[5] ***See*** *CALLS Order*, ¶ 78. Price Cap CMT is defined as the total revenue a filing entity is permitted to receive for SLCs, presubscribed interexchange carrier charges ("PICCs"), and carrier common line charges. ***See*** 47 C.F.R. Section 61.3(cc). Price cap CMT revenue also

artificial regulatory incentives to a greater extent than would be required by economic efficiency. ***See*** id., ¶ 111. These important public benefits can be achieved only if the Commission continues the phase-in of the SLC caps. ***See*** id., ¶ 70.

The Price Cap CMT is a revenue-based measure, because price cap regulation long ago broke any connection between rates and regulatory accounting costs. ***See*** *CALLS Order*, ¶ 16. Since it was implemented in 1991, price cap regulation has provided an incentive for the carriers to become more efficient by meeting or beating the price cap productivity-based "X-Factors." ***See*** *LEC Price Cap Order*, 5 FCC Rcd 6786, ¶ 28-30 (1990). Over the years, the Commission has steadily increased the X-Factor from its original level of 3.3 percent to 6.5 percent to share with consumers part (but not all) of the increased productivity that the price cap carriers have achieved. ***See*** id., ¶ 100; *Price Cap Performance Review for Local Exchange Carriers*, 12 FCC Rcd 16642, ¶ 141 (1997). In addition, price cap regulation allowed the carriers limited flexibility to raise or lower rates in each "basket" of services, with the result that revenues for services and groups of services lost any relationship to costs over time. ***See*** *CALLS Order*, n. 15. Not only does the Price Cap CMT include the legacy of a decade of price cap regulation, but the Commission also decided to include recovery of marketing expenses and transport interconnection charge revenues previously collected through other common line and traffic sensitive charges in the Price Cap CMT revenue pricing limit. ***See*** id., ¶ 70. In the first access charge reform order, the Commission adopted a plan to reduce per-minute access charges, including the transport interconnection charge, through rate restructuring and through targeting of price cap reductions rather than through cost-based rate prescriptions. ***See*** *Access Charge*

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includes marketing expenses and transport interconnection charge revenues collected through the PICCs. ***See*** *CALLS Order*, ¶ 70.

Reform, 12 FCC Rcd 15982, ¶¶ 214-243 (1997). On review, the Court upheld the Commission's decision to use a market-based approach rather than a prescriptive approach. ***See*** *Southwestern Bell Telephone v. FCC*, 153 F.3d 523, 549 (8th Cir. 1998). The *CALLS Order* continues with this approach by including recovery of transport interconnection revenues and marketing expenses in the common line category. For these reasons, the Price Cap CMT revenue per-line has no direct relationship with common line costs. Rather, it is the result of the price cap regulatory process over the past ten years, and it represents the maximum revenues that the price cap carriers are entitled to receive under the price cap formulas.

Full implementation of the CALLS plan is essential to achieve the balancing of carrier and consumer interests that the Commission considered in adopting the plan. As the Commission noted, CALLS is a cohesive plan and all its underlying issues are interrelated. ***See*** *CALLS Order*, ¶ 49. The price cap carriers agreed to a $2.1 billion up-front reduction in access charges with the understanding that they would be able to achieve the benefits of the plan over time as they reduced their per-minute access charges to the "target rates." ***See*** id., ¶¶ 30, 160-163. One of the most important aspects of the CALLS regulatory regime is that it provides "relative certainty in the marketplace during its five year term." Id., ¶ 37. It provides a clear blueprint for all parties, including local exchange carriers, competitive local exchange carriers, and interexchange carries, in making their business plans and in attracting capital. The scheduled increase in the primary line and single line business SLC cap to $6.00 is an integral part of the overall CALLS plan and an important component of the regulatory stability anticipated. For these reasons, it should not be hindered in any way.

Under the CALLS rules, the SLC caps for residential and single-line business lines increase to $6.00 as of July 1, 2002 and to $6.50 as of July 1, 2003, or to the average Price Cap

CMT per-line, whichever is lower. As is shown in Attachment B, some Verizon states have CMT per-line revenues that are below the $6.00 SLC cap.[6] As a result, SLCs in these states will remain below $6.00 on July 1, 2002. These data show that the Price CAP CMT revenue per-line is performing its intended function as the ultimate limit on SLCs.

In Attachment C, Verizon also provides current calculations of its "base factor portion" ("BFP") costs, which were used prior to the CALLS plan as the price limits on SLCs except where SLC caps applied to residential and single-line business lines. The BFP revenue requirement cost components and end user demand in this filing are based on the Year 2000 ARMIS 43-01 report. The revenue requirements were calculated according to the method prescribed by the Commission in the 1997 Annual Access Tariff Investigation designation order.[7] In some cases, these costs are below the Price CAP CMT per-line, because the CMT includes revenues that were previously recovered through PICCs, carrier common line charges, and transport interconnection charges in addition to revenues recovered through BFP-based SLCs.[8]

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[6] These data are taken from the 2001 Annual filing Tariff Review Plan, Form CAP-1, line 460, Verizon Telephone Companies, Transmittal Nos. 53, 54, 56, effective July 1, 2001.

[7] ***See*** *1997 Annual Access Tariff Filings,* 12 FCC Rcd 11417 (1997), n. 42 & Appendix B. These data include marketing costs allocated to the interstate jurisdiction, to be consistent with the Commission's decision to include marketing costs in the Price Cap CMT.

[8] ***See*** *CALLS Order*, ¶ 70. For purposes of comparison, Verizon added marketing expenses to its calculation of base factor portion costs, because the Price Cap CMT revenue per-line includes marketing expenses previously recovered through charges for non-primary residential lines and multi-line business lines. ***See*** id., ¶ 102.

However, even under the previous rules, total average common line revenues per-line often exceeded the base factor portion per line, because the price cap formula, rather than cost, served as the upper limit on common line charges. In addition, the common line basket did not include transport interconnection charge revenues. For the reasons discussed above, the Commission decided in the CALLS proceeding that it was more economic for the local exchange carriers to recover all of these revenues directly from their end users through flat-rated SLCs rather than through a combination of SLCs and access charges.

In Attachment D, Verizon also provides estimates of forward-looking costs of providing voice grade retail residential service as requested in the Public Notice. The per-line costs in these studies are higher in some cases than the Price Cap CMT per-line and lower in others. However, in neither case should they be used to change the scheduled increases in the SLC caps. As noted above, the price cap system is not based on cost, and when access charges were based on cost, it was actual incurred cost, not a lesser measure of forward-looking cost. Although the Court of Appeals reversed and remanded the CALLS Order regarding the Commission's justification of the X-Factor and the $650 million universal service fund, the Court endorsed the Commission's rejection of arguments that the Commission should have used forward-looking costs to restructure access charges, noting that "the 1996 Act does not compel the FCC to conduct forward-looking cost-studies because the cost-study requirements of § 251(c)(1) and 252(d)(1) do not apply to the interstate access services at issue in this petition."[9] The Commission should continue with the market-based approach and allow the phase-in of the SLC caps to continue.

Respectfully submitted,

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[9] *Texas Office of Public Utility Counsel v. FCC*, 265 F.3d (5th Cir., 2001).

ATTACHMENT A

THE VERIZON TELEPHONE COMPANIES

The Verizon telephone companies are the local exchange carriers affiliated with Verizon Communications Inc. These are:

Contel of the South, Inc. d/b/a Verizon Mid-States
GTE Midwest Incorporated d/b/a Verizon Midwest
GTE Southwest Incorporated d/b/a Verizon Southwest
The Micronesian Telecommunications Corporation
Verizon California Inc.
Verizon Delaware Inc.
Verizon Florida Inc.
Verizon Hawaii Inc.
Verizon Maryland Inc.
Verizon New England Inc.
Verizon New Jersey Inc.
Verizon New York Inc.
Verizon North Inc.
Verizon Northwest Inc.
Verizon Pennsylvania Inc.
Verizon South Inc.
Verizon Virginia Inc.
Verizon Washington, DC Inc.
Verizon West Coast Inc.
Verizon West Virginia Inc.